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Nov. 16, DJIA 815.70; PTI 1095; A-D Ratio –19.88

THE PICTURE: Over the years we've seen that the lenders in this nation have been total suckers. They lent out their money only to see those loans become worth less and less due to inflation. And the borrowers have been smart, even brilliant. They've borrowed dollars and paid back with quarters and dimes. So the word has been, "Borrow your head off, buy, buy, buy, and you're a genius. Lend and save, lend and save, and you're both stupid and broke."

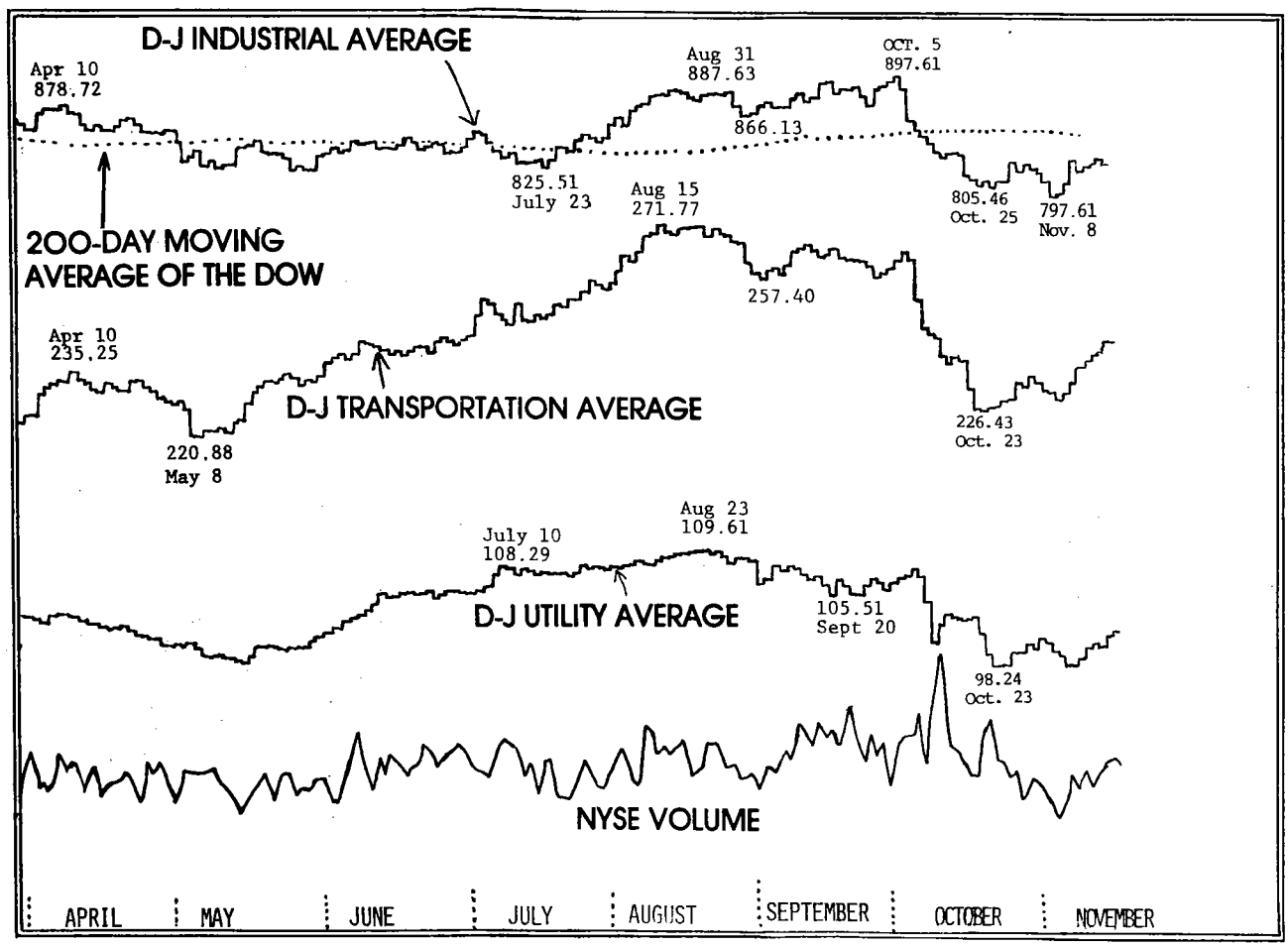
Now there's *something new* in the equasion! Suddenly, the guy who's liquid, who has money in his hand, the woman who has cash, suddenly they're getting respect. More than that, they find themselves in a veritable financial "candy store." How come? Well, today they're paying you for being liquid, for having cash. "Let's see, do you want 14% here in a banker's acceptance, do you want 12% in a T-bill, how about 13½% on a B-rated bond or 13% in a C/D?"

And what happens if there's a credit crunch late this Winter or maybe in the Spring? Every dog has his day, and the day of the fellow who's got cash, who's liquid, might just be arriving. What about the borrower? What happens if things get rough and it's hard to come up with those monthly payments? "Ah, forget it, that just ain't going to happen. And if it does, if the worst comes to the worst, the Government can always call a debt moratorium."

My own feeling is that if the American economy goes "into the tank" and the stock market rolls over into a major bear market, history will record the reasons as (1) too much debt, (2) too much Keynesianism, and (3) far too much emphasis on how we live instead of what we're living for.

Some years ago I said that the ascent or descent of nations can be traced via the rise or fall in their gold reserves. I said that whether a nation loses gold through sales, auctions, transfers or anything else, the very **act of losing gold** is a sign of decline. The US has been losing gold in one way or another for years. And now the obvious signs of weakness are appearing for all to see. The Cuban backdown, the Iranian mess, the dollar weakness, the loss of world prestige. I'm afraid the worst is yet to come, and I'll go into that in another section of this Letter.

I don't know how to save the world. I don't know how to save the US. The fact is that I've spent much of my adult life trying to save myself (from a spiritual standpoint), and I don't know how good a job I've done there. But after decades of pondering the problem, I've come to one conclusion: The US (and the world) will only be "saved" when **each person takes responsibility for himself.** A great system run by, and populated by mediocre people is going to fall apart in due time. Any reasonable system populated by outstanding people is going to work.

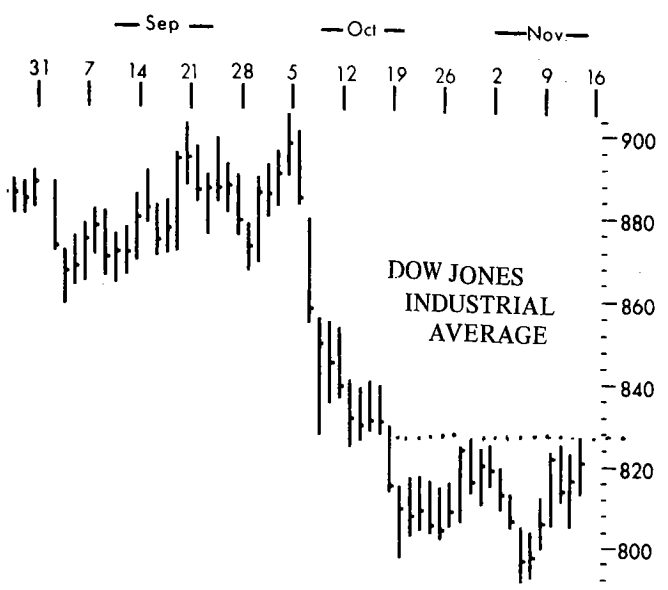


We've got a great and bountiful geographical land mass called the United States. We've got a great Constitution, and we have many great individuals in this nation. Down in New Orleans I heard Dr. Franz Pick tell his audience that the biggest business in America is "corruption." I didn't laugh (as most people did) when he said that. I didn't laugh because I'm fairly sure that it's true. If and when each American turns honest in every way, I see this nation fulfilling the destiny that I'm sure was intended for it. But the "best laid plans of mice and men" oft go astray. I'm sure the Founding Fathers of this nation, as they survey our efforts from somewhere above, know the sad truth of that ancient adage.

THE MARKET: All right, now forget all my scoldings, my warnings, my crystal ball-gazing. Why? Because it's the market itself that tells the real story. No story is told in an instant, and no stock market story is told in a day or even a week. Please turn to the page 1 chart. The stock market, like the bond market, has gone through a panic decline. On October 5 the Dow Industrials stood at 897.61. Just 23 trading days later, on November 7, the Dow closed at 796.61. This represented a loss of 100.94 points. The A-D ratio, during the same period, lost over 5 points. That kind of action constitutes a panic, and the aftermath of a panic is usually an AUTOMATIC recovery that tends to recoup at least 50% of the losses (this was discussed in the last Letter).

The pattern of the Averages would seem to support the thesis that the market is forming the post-panic bottom. Note on the chart that at the 797.61 low, the Dow had broken well below its preceding low level of 805.46. This new low was NOT confirmed by the Transports. Thus, we have a downside non-confirmation, an element of definite technical strength in the price structure. Following the non-confirmation, the Dow rallied back to a November 15 closing value of 821.33 (note how often that fateful 821 level comes into play!).

It is well to note (see accompanying WSJ chart) the emergence of a possible (or probable) "head-and-shoulders bottom" pattern. On November 16 the market started down again, and at this point I believe that any decline or sideways movement of a few days or so (in which the Dow held above 800) would complete a right shoulder on the pattern shown. Following a right shoulder, if a new advance takes the Dow *above the 824 area* we would have a completed bottom and the beginning of what could be a powerful recovery. (Note: obviously, if a decline takes BOTH Averages below recent lows, all bets on a bottom are off and the decline will extend. But the strength in the Transports suggests that the bottom thesis is much the more likely outcome).



For those who have the temperament and the inclination to trade, there are a number of stocks that appear to be in strong positions. Among these are **Louisiana Land, Fluor, Howard Johnson, Standard of Indiana,**. Strongest of the Dow stocks are **Allied Chemical, Exxon, Standard of California and Texaco.** Trading is NOT for everyone, and these are tricky markets. Nevertheless, for those who have the inclination this could be a good trading period. (Note: unfortunately, we still have not seen the kind of MAJOR bottom that I have been patiently waiting for).

Turning (see page 3) to the chart of the Dow, the Primary Trend Index (PTI) and the A-D Ratio, we see a most interesting picture. For the benefit of new subscribers I should explain that the PTI is my own indicator, an amalgam of 8 critical averages and indices. The PTI reflects the build-up (or decline) of technical strength in the market. From its October peak of 1149, the PTI dropped to a November low of 1076. This was a rapid loss of 73 points–compared with last year's loss of 122 points. But it is important (and it appears bullish) to note that the PTI has, so far, NOT violated its major rising trendline. Thus, despite the panic, the PTI's main upward trend remains very much intact.

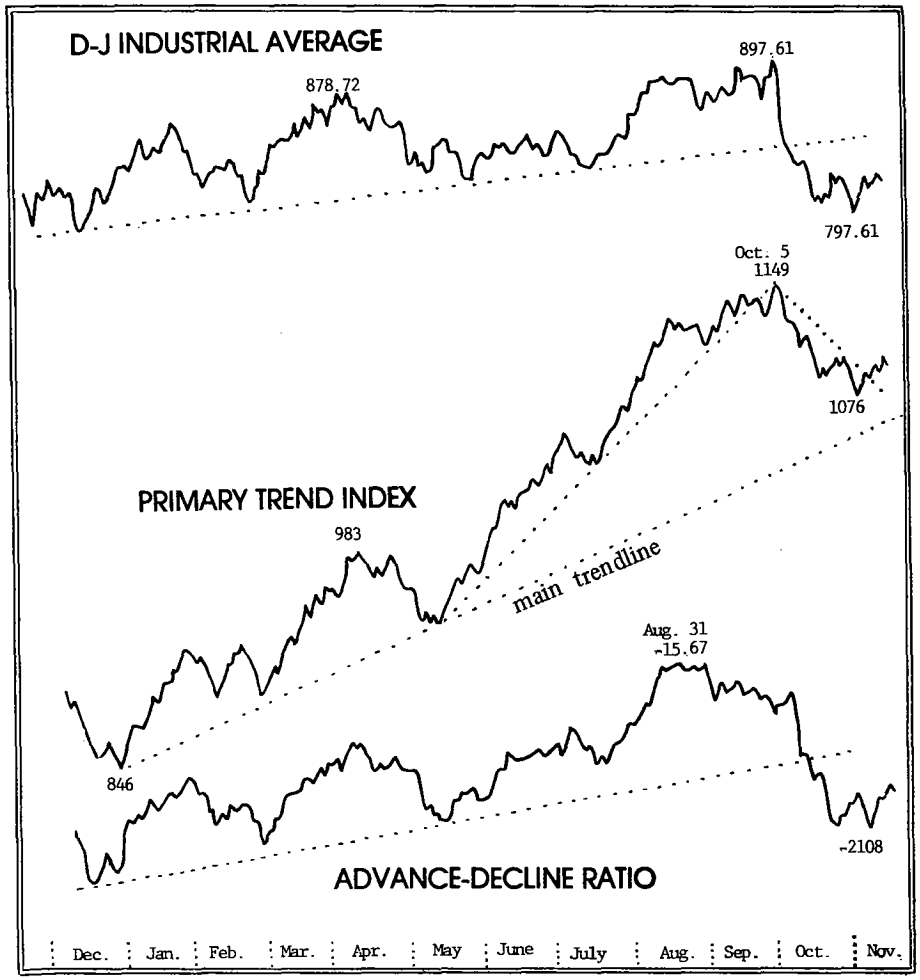
Last week the PTI rallied, bettering its most recent downward-slanting trendline. So it will be extremely important from this point on to note whether the PTI can continue to gather strength and perhaps reach (or better) its October 5 high. The fact is that the PTI has given ground rather grudgingly, and a persistent rising trend in the PTI from here will tell us that the stock market sees something far better than today's steady stream of bad news suggests.

At the bottom of the chart we see the A-D ratio, a proxy for all the stocks on the NYSE. Between August 31 and October 23 the A-D ratio lost 5.24 points. And this compares with the 8.84 points lost during last year's "October Massacre." The panic low for the A-D ratio was struck last year in November at minus 23.09. This year's low (October 23) came at minus 20.91, about 2 points higher. Thus, the A-D ratio is still floating within the area of last year's high and last November's low. But as you can see on the chart, the A-D has broken sharply below its rising trendline of the past year.

Conclusion: This is no time to play genius! Let the market and particularly the PTI tell us what lies ahead. It's great to have opinions, it's even acceptable to have a few prejudices, but in this business we ACT on the facts, and those the market supplies! So far, the verdict is that the market is acting far better than the news.

INTEREST RATES: Here's a statistic no one but yours truly keeps. Since August 16, the advance-decline record for NYSE bonds has been unbelievable. Out of 65 trading days, the A-D for bonds has been down 59 times (i.e., more declines than advances). That's the worst A-D series in any item I've ever seen or heard of! Bonds must be fantastically oversold.

No one knows whether we've seen THE final peak for interest rates, but my guess is that we've certainly seen an intermediate peak. Note my chart (bottom of page 3) of three important money instruments. In each case, it looks to me as though we've passed the top, and my guess now is that rates should level off for

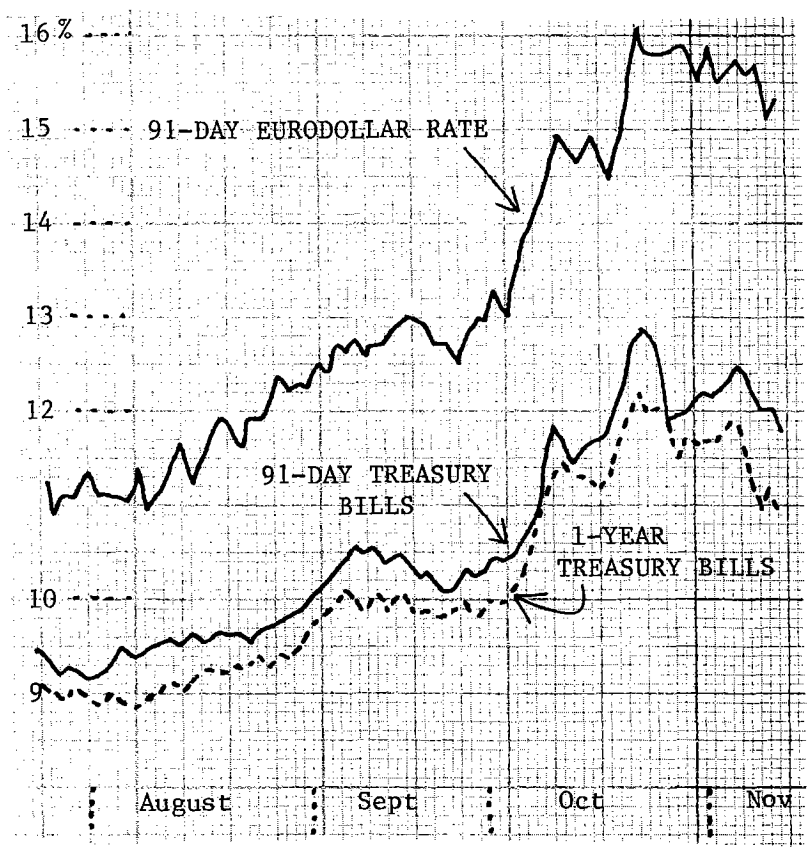


a while. On November 16, the banks raised the prime rate to another record high of 15.75%, but this is not going to produce a new high yield for short-term instruments. My suggestion: if you're rolling over T-bills go out to 6 months or even a year. If you are tempted to buy T-bonds, don't go over further than the mid-1980's. But I'd still keep the great bulk of your money market assets in short term instruments. Who knows what this Spring will bring.

PAYING THE PIPER: I have a confession to make. I wrote the following piece about three weeks ago. I didn't publish it because I thought it was too depressing, too downbeat. Last week I received Harry Schultz's latest report, and the report began with what Harry termed "perhaps the most important article I've ever written." Harry's article agreed with and confirmed my own information. So due to Harry's courage, I screwed up my own lagging courage and decided to run this piece. Here it is. I hope it does some good in places where good can be done.

* *

I spent about 4 hours a few nights ago with a man I have known for 17 years. He's a very low-profile, tight-lipped type, a man with a razor sharp mind, and a man whose intelligence I have always admired. This man's business is collecting, collating and publishing facts and statistics on the US and the world's military-industrial complexes and their capabilities. What he told me left me in a state of semi-shock.



I'm going to run through (in haphazard fashion) some of the things Mr. X told me. He stated that the US has been losing out on the military-capabilities front–to Russia. The gap is now increasing at an ACCELERATING pace. Mr. X says we are now about 5-6 years behind Russia, and he adds that it could take 10 years (assuming an all-out US effort) to catch up.

Mr. X states that the major US suppliers such as Boeing, Northrup, Rockwell, McDonald Douglas, are now on a 3-shift per day basis. They have backlogs of work stretching out 5 years. Shortly the backlogs will be up to 7 years. "You remember the boom days of the defense contractors back in 1960-64," he added, "this thing is bigger today!" San Diego is a prime defense city, so I knew what he was saying. "Go down to Balboa at 30th St. in San Diego," he commented, "and you'll see little technology companies and suppliers on every block. The R&D companies are dotting the landscape like you've never seen before" (I did go down there, and he's right).

He explained that our defense suppliers are booked up. Mr. X said that they couldn't even handle huge new contracts. In other words, vast infusions of new money for US defense would fall on an industrial complex that wasn't capable of really moving on the funds.

He said that in 1-2 years he expects the material that he's talking about to be obvious, common knowledge. You can see some of the results of the Russian superiority already, he noted. When John Kennedy saw the Russians in Cuba, he gave the Russians "so many hours" to get out. Now

we finally learn of thousands of Russian soldiers in Cuba and we tell the Russians, "Look, we don't like this at all."

(Since this piece was written we now have the Iranian crisis. What's our timorous response to the kidnapping of 65 Americans in the Embassy. "We'll cut off Iranian oil before the Iranians cut it off for us!" Conclusion: a US reaction that is as pathetic as it is impotent).

I asked Mr. X about SALT II. He answered, "There's not going to be any big war. The US wouldn't dare start a war with Russia at this time. And the Russians are doing too well with peace; they don't need a war! As far as SALT II, what do the Russians have to lose? They're happy to have the US continue to think in terms of peace and limiting arms capabilities. It's a political thing. Carter and the boys see the situation, and they've arrived at an answer–accord with the Russians, cooperation, peace, limit arms. The Russians love it. What can they lose? And the military span between the US and Russia increases and increases.

"The Russians," continued Mr. X, "are beginning to experience shortages on the oil and energy front. With Russian power rising across the face of the globe, who do you think is going to get Arab oil in say 4 or 5 years? Already the shadow of Russian power is protecting the Arabs. The Arabs can do almost anything they want, and the US is in a position of saying nothing and paying the price. Compare this with the probable US response say 15 or 20 years ago!"

Mr. X thought that the Vietnam War was a watershed disaster period in the history of the US. He feels that the OPEC situation is a second disaster. We're delivering $40, $50 billion a year to the Mid-east, he said; the wealth of this country is going to the Arabs. Big money always controls the markets, and the big money is now the Arabs.

I asked him how the situation could be reversed. As far as the military situation he answered, he thought it was irreversible. "We've insisted on the good life and we've been living in a state of arrogant complacency for years. The Russians, on the other hand, have sacrificed almost all consumer pleasures for their military build-up." He said that as far as he was concerned, you can't continue to have the kind of prosperity the US has enjoyed when you're not the leading or at least an equal military power.

"What about China?" I asked. "Forget China," he retorted. "They're decades behind. They have no large military-industrial set-up. The Chinese are a nation of peasants and farmers. When they went into Vietnam they were slaughtered. The figures on Chinese casualties are too horrendous to publish. At this point, China has only one asset–population. They have no industrial capabilities, no credit, nothing. Look, a few months ago everybody was excited about selling China all kinds of merchandise. What do you hear about it today–nothing. Today, Russia doesn't fear China at all. The Chinese are back in the agrarian age, as far as Russia is concerned.

We talked about a great many other things, and I left very depressed with what I heard. I thought about my children, my own life and my country. I've been very worried about the demise of US power. I've been convinced all along that the US was destroying its power and its currency through greed, lies and arrogance. With the dollar being debased daily, the US (Volcker) is now choosing to fight inflation with interest rates. But how far will he go? And it's obvious that the interest rate surge is an attempt to make holding the dollar more attractive.

My Conclusion: I think a few people in Washington are aware of this story. I note that all talk of "cutting the defense budget" in the US has suddenly ended, and thus consciously or unconsciously Washington suspects the disaster that is building. I don't think the situation has to end up in war. I don't think the US is even remotely capable of fighting a big war with Russia. Russia knows it and Carter probably knows it.

What I see ahead is a vastly, dramatically changed standard of living in this country. We're going to have to live with less energy, higher priced energy, less traveling, smaller houses, fewer luxuries, higher interest rates, and a general belt tightening such as has not been seen since the 1940's. I could be wrong, but that's how I see things going. I believe that by 1980-81 we'll be seeing the new, diminishing standard of living in the US. And then there's the problem of the debt . . .

DOW BREADTH: Sometimes the simplest things work best. For about 5 years I have laboriously (each day after the close) taken a count of the 30 Dow Industrials and specifically the number of the 30 that rallied and declined. I use the plurality to construct a Dow advance-decline line. This line shows me whether the strenth (or weakness) in the Dow **price** is being confirmed by the majority of the Dow issues or not.

The instance of divergence between Dow breadth and price has been rare. Yet, since early-1978 a strange technical situation has emerged. In May both the Dow and its A-D recorded recovery highs. But on the Dow rally into September, the A-D diverged dramatically. This is shown on the chart in the section marked 1. By October it was clear that the situation was deteriorating as a rally failed in both components. This gave way to the "October Massacre" of 1978.

At section 2 on the chart we see a bottom divergence. Here both indicators hit lows on November 14. A rally ensued followed by a new decline in December. The December decline took the A-D to a new low, a low that was unconfirmed by the Dow. This non-confirmation set the stage for a new rally.

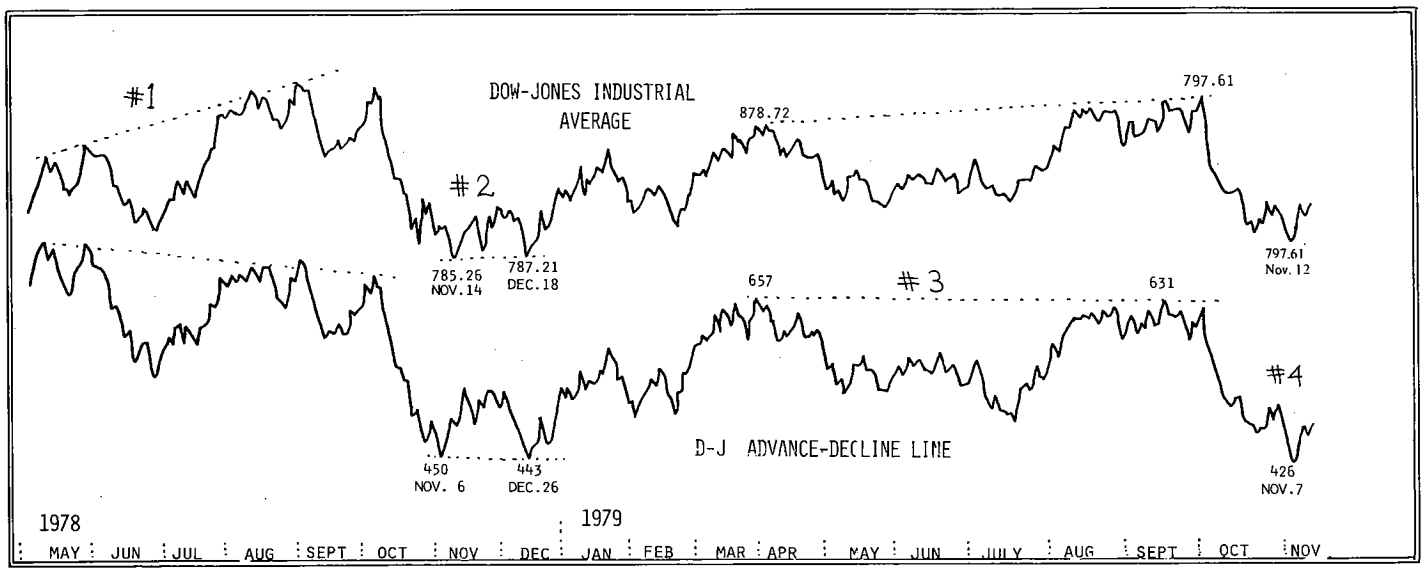
The rally carried into April. By early April the Dow had risen to a peak of 878.72, the Dow A-D to 657. A new decline followed (section 3) and here the Dow A-D broke down while the Dow held. This bottom non-confirmation was followed by an advance which by October 5 took the Dow to a recovery high of 897.61.

But note at the new Dow high, the Dow A-D was still 26 points below its earlier April high. In the face of this flagrant top non-confirmation, the Dow and the market toppled in the now-famous " Second October Massacre" (of 1979).

On November 7, 1979, the Dow A-D broke below all previous lows going back to 1975. The Dow, however, held above its November, 1978 low of 785.26 (4 on the chart).

This remarkable new break in the Dow A-D line is telling us something. Here's what I believe it is telling us. We now have a major bottom divergence in that the Dow A-D has penetrated a low made a year ago–while the Dow has refused to confirm. The non-confirmation should call for a rally and I would expect a good advance based on the importance of this major non-confirmation.

Note: on the larger picture, every period of divergence eventually rights itself. Or to put it another way, the indicators invariably end up by getting "in gear." This getting in gear process almost always resolves itself on the downside.



Thus, the **quality** of the rally now being attempted is of vital importance. If, following the bottom non-confirmation, a good rally fails to materialize, we can look for the Dow to follow the A-D down and thus eliminate the long area of divergence.

NOTES & QUOTES: The Chrysler situation can only be described as weird. Here's a corporation that owes over $1 billion in unfunded pension liabilities to its workers. Here's a corporation that is on the verge of bankruptcy and may need up to $3 billion to keep going. Yet Chrysler gives its workers a 22% wage increase over a 3 year period, an increase that will cost Chrysler over $1 billion. That's borrowing to pay its workers, and it's insanity.

Meanwhile, GM loses money during its 3rd quarter and Ford loses over $1 billion during 1979 on its N.American operations. The bitter and unbelievable truth is the US auto makers have been selling their cars too cheap! When sales are good (as they have been up to very recently) and you can't make a profit, you're selling your item too cheap. Which tells me that the auto industry has not been able to handle inflation. And now comes consumer resistance. . .

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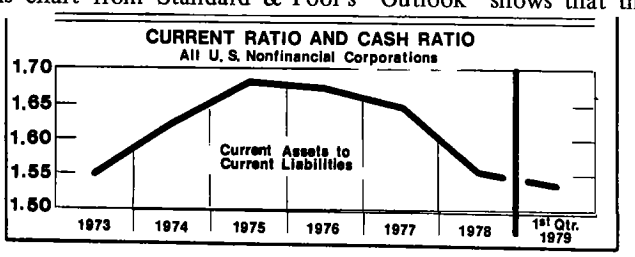
Speaking of finance, here is one area of money that bothers me. This chart from Standard & Poor's "Outlook" shows that the



current ratio (current assets to current liabilities) for all non-financial corporations in the US has been falling ever since 1975. It is now at an all-time low of 1.53. This means that if a recession arrives, the squeeze on corporations could be unmerciful due to their extremely low level of cash reserves. The same thing is true for consumers. The US consumer is now saving at a record low of 4.1% (vs. 22% in Japan, 12% in Germany). The average US citizen is in just as poor shape to survive a recession as is the average US corporation. Yet we're all in great shape for more prosperity and more inflation–if it arrives.

* *

The latest issue of the *Bank Credit Analyst* (1010 Sherbrooke St., West, Montreal, Canada H3A 2R7) provides some interesting and ominous observations about the current situation. BCA notes that *"The evidence of the past indicates clearly that they (the Fed) don't know how to measure the money supply variables properly and, even apart from mistakes, they don't know within a broad range what the appropriate target levels should be because of inflation and rapid financial innovation . . . . (the Fed) could well blunder into severe overkill once again."*

"However, with both private and government borrowing requirements running at enormous levels, the Fed, by threatening to cease the monetizing of this debt creation, created near panic conditions. . . . The Fed, if it sticks to a reserve target that is unrealistic, could easily create a credit crunch of enormous magnitude."

"Our guess at this point is that the Fed has already set in motion forces that will create a major downturn in economic activity. The early signs are apparent and by late this quarter or as early as first quarter 1980, the US economy will likely be in a major, cumulative economic decline."

LATE NOTES: It's been said the test of a true professional trader is as follows: he will buy a stock, sell it out at a minor loss (because he doesn't like the market), then buy that same stock back at a **higher** price (because he now likes the market action). This is simply another way of saying that the professional trader views the market totally unemotionally. He might as well be playing a game of bridge with his neighbor. He doesn't quit because he's lost four games running. He continues because he loves the game and he knows he'll get the right cards in due time.

I don't recommend trading for many people. After 21 years in this business, I would say that if the average person bought ONLY when the market smashed to major lows as described in the last Letter, he would be far better off. But there are many people who want to trade, who want to play the intermediate swings, and who am I to say, "You can't do that."

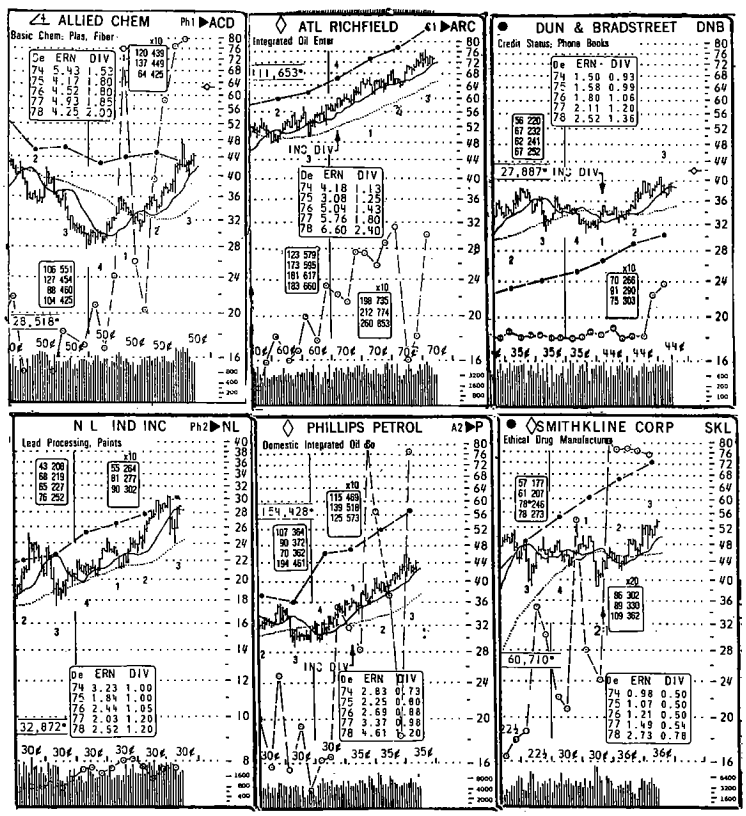
The market may do nothing on the upside here, but it is giving the appearance of trying to put a year-end rally together. New lows have contracted, downside non-confirmations abound, the Utilities are giving a good account of themselves and short-term interest rates have come down.

Stocks that won't go down during panic declines have, as a rule, got a lot going for them. I include here charts of a few stocks that have resisted the downside admirably. The odds say that these same stocks will want to go up during any advance in the market.

But I want to say again that for the vast majority of subscribers, trading the swings is going to be a tough proposition. One reason is that I can't get Letters off to them telling them that this or that rally is topping out or that the technical situation has "suddenly worsened, so sell." This Letter goes out every other Wednesday, and in fast swinging markets traders need almost daily information.

I do put subscribers into the big moves, the **major bases** such as 1974. These are the areas that are safest, although they always look scariest. They are also the ones that may lead to huge potential gains in the market. Personally, they are the ones I wait for. Anything I do with temporary bottoms such as this one is minimal. The odds are just not strong enough on the plus side for me. And I don't particularly like speculating (much less gambling), and I therefore (with my own money) wait for the rare areas in which the market provides "bargain buying spots" following dramatic (often catastrophic) declines.

(Charts courtesy QUOTE Digest, PO Box 213, Wichita, KA 67201).



GOLD: I keep a ratio of gold to stocks (London gold fix divided by S&P 500 Industrials). During 1979 this ratio has spiked up from 405 to a peak of 695 recorded on October 24. From there it has turned down. On November 15 the ratio (at 651) broke below its own 8-week moving average. It's too early to draw any definitive conclusions, but we can say that since October 24 the stock market has been outperforming gold on a relative strength basis.

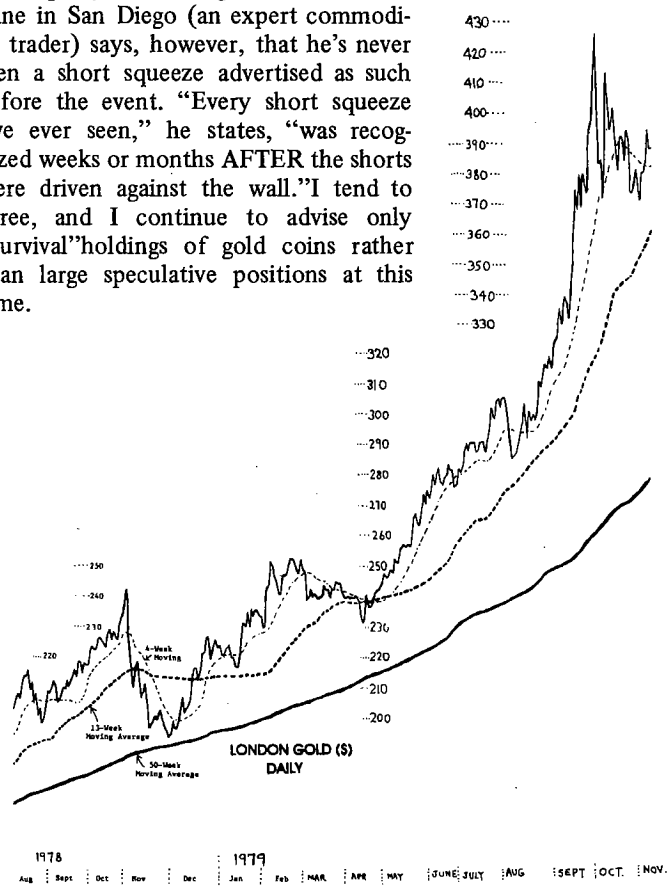
What's so unusual about this particular reversal is that it has occurred in a period that would "seem" to so obviously favor gold. The downside penetration of the 8-week moving average of the ratio also came following a great upward spike. Therefore, it will be most interesting and important to note whether the ratio has now topped (in favor of stocks rather than gold). Since 1976, the ratio has broken below its own 8-week moving average on 9 separate occasions, but each time the reversal was short-lived and within a few weeks the ratio broke out again in favor of gold rather than stocks. We'll follow this closely in forthcoming Letters.

This daily chart of gold (second London fix) shows the tremendous upward thrust of the metal since the November, 1978 low, a thrust that has better than doubled the price in a period of a year. Right now we are seeing the biggest "congestion" pattern in gold since its 1976 low of 103.50. Whether the current period of congestion represents distribution or accumulation no one can possibly know.

Gold is literally on top of its 4-week moving average, as you can see on the chart. The much more important 13-week moving average now stands at approximately 355 while the 50-week moving average is at the 280 level. A few Letters back I noted that it has been 7 months since gold has backed off and touched its 13-week moving average. This is the longest such span in recent years. Therefore, it would not be surprising to see gold either hold here as its 13-week moving average rises to meet the price, or to see gold decline to make contact with the MA which is now in the 355 area.

Jim Sibbet (61 S. Lake Ave., Pasadena, CA 91101), a very knowledgeable metals advisor, is of the opinion that silver is about to enter a short squeeze with the Hunt family and the Arabs intending to take delivery on vast amounts of silver. If so, silver should go substantially higher with gold following in sympathy.

An equally knowledgeable friend of mine in San Diego (an expert commodity trader) says, however, that he's never seen a short squeeze advertised as such before the event. "Every short squeeze I've ever seen," he states, "was recognized weeks or months AFTER the shorts were driven against the wall."I tend to agree, and I continue to advise only "survival"holdings of gold coins rather than large speculative positions at this time.



NEXT MAILING: December 5th